

**COMMONWEALTH OF MASSACHUSETTS  
DEPARTMENT OF TELECOMMUNICATIONS AND ENERGY**

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**Investigation by the Department of Telecommunications and Energy )  
on its own Motion into the Appropriate Regulatory Plan to succeed )  
Price Cap Regulation for Verizon New England, Inc. d/b/a Verizon )  
Massachusetts' intrastate retail telecommunications services in the )  
Commonwealth of Massachusetts )**

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**D.T.E. 01-31  
Phase II**

**COMMENTS OF THE ATTORNEY GENERAL**

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**COMMENTS OF THE ATTORNEY GENERAL**

**I. INTRODUCTION**

Pursuant to the Department's procedural schedule set in its May 8, 2002 Phase I Order, the Attorney General files these comments for the purpose of responding to Verizon Massachusetts' ("VZ-MA," "Verizon" or "Company") June 5, 2002 "Compliance Filing" ("Phase II Plan").<sup>1</sup> Verizon intends to replace the Price Cap Plan (*NYNEX*, DPU 94-50) that expired last year with its Phase II Plan. In these comments, the Attorney General identifies several aspects of Verizon's Phase II Plan that merit investigation and urges the Department to set a procedural schedule that allows for discovery, pre-filed testimony, evidentiary hearings, and briefing.

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<sup>1</sup> Although labeled as a compliance filing to Phase I, Verizon's June 5, 2002 filing will be referred to here as its "Phase II Plan."

## **II. PROCEDURAL HISTORY**

### **A. Phase I Opening Order, Verizon's Phase I Plan, and Phase I Scoping Order**

In its Order opening its investigation into Verizon's alternative regulation plan, the Department said that it would contrast the effectiveness of the Price Cap plan established in DPU 94-50 with an "appropriate regulatory plan for Verizon." DTE 01-31 (Phase I) Vote and Order to Open Investigation (February 27, 2001), p. 1. The Department noted that the Price Cap Plan expired August 15, 2001 and that ratepayers received \$296 million from Verizon while under the Price Cap Plan. *Id.* at 2. The Department then ordered Verizon to file a proposed plan that included service quality regulations, a plan to revise intrastate access charges similar to the Federal Communications Commissions' interstate access charge reforms, and a component for regulating intrastate retail prices. *Id.*

In response, Verizon filed a regulatory plan on April 12, 2001 ("Phase I Plan"), that shifted the Touch-Tone charge in a revenue-neutral manner, capped the residential dial tone and usage rates for three years, allowed other residential services to change only on a revenue-neutral basis, and allowed business services and all other intrastate service to fluctuate according to market demands. Verizon proposed to continue the service quality plan established in DPU 94-50 with a modification to the penalty payment methodology. Verizon's Phase I Plan also provided for the possibility of a reduction in intrastate switched access rates. *Id.*

On June 21, 2001, the Department bifurcated the investigation and halted any further consideration of Verizon's Phase I Plan. Phase I Scoping Order. The Department stated in its Phase I Scoping Order that in Phase I it would examine whether there was sufficient competition to deregulate any of Verizon's regulated residential or business services. Phase II of the

investigation was designed to consider which alternative regulation plan – including traditional cost-of-service, indexed price cap regulation, and any intervenor-proposed plans – might be most appropriate for retail services that are not sufficiently competitive to merit removal of pricing constraints. *Id.*, p. 17-19.

## **B. Phase I Final Order – Verizon as a Monopoly Provider**

The Department, in its May 8, 2002 Phase I Final Order, tentatively concluded that Verizon is a monopoly provider of residential retail services and some business services and that these services must remain subject to some level of regulation. The Department also tentatively concluded that it is not feasible or desirable to resurrect traditional cost-of-service regulation for these regulated rates, but rate freezes, price caps, revenue caps are feasible (Phase I Order, p. 97-98). The Department also concluded that an “inflation minus productivity” price cap regulation plan might not be the best mechanism for regulating basic residential services because historic evidence shows residential rates are likely below efficient levels.<sup>2</sup> Additionally, the Department determined that rates must necessarily be just and reasonable if they fall within a range set by a floor of incremental costs (with no recovery for joint and common costs) and a ceiling of stand-alone costs (incremental costs plus all joint and common costs (Phase I Final Order, p. 99-100).<sup>3</sup>

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<sup>2</sup> The Department contends in the Phase I Order that a price cap is not designed to determine whether Verizon’s price for any particular rate element is a just and reasonable price (Phase I Order, pp. 98-99); yet, the Department took just the opposite approach when reviewing Verizon’s annual proposed rate changes under the Price Cap Plan. *See, e.g., Verizon’s Fifth Price Cap Annual Compliance Filing*, DTE 99-102, Order (August 3, 2000), p. 16 (“the Price Cap Plan is designed so that any rate changes that are in compliance with the pricing rules will result in just and reasonable rates.”)

<sup>3</sup> The Department states that it will conduct a separate calculation of the price floors and price ceilings for basic residential services after the Department issues its UNE order in DTE 01-  
(continued...)

That price floor, according to the Department, will be the cost that Verizon charges for the retail rate if it were priced as an unbundled network element (“UNE”). Phase I Final Order, p. 101.

**C. Verizon’s Phase II Plan – Increased Rates and No Service Quality Plan**

On June 5, 2002, Verizon filed its compliance filing to the DTE’s May 8, 2002 order in DTE 01-31 Phase I, Verizon’s Alternative Regulation Plan. In this Phase II Plan, Verizon proposes to:

- Raise all Massachusetts residential customers’ basic monthly rate for telephone services by \$1.90 to \$2.37 per month by increasing the monthly dial tone charge from the current \$9.91 to \$11.81 or \$12.28. Verizon proposes to raise all residential rates to recover the claimed lost revenues (\$59 million annually) from changes in access fees it used to recover from interexchange carriers like AT&T, WorldCom, and Sprint.<sup>4</sup> Also, Touch-Tone service (formerly optional) is rolled into the rate increase.
- Cap future rate increases for residential basic service at five percent per year, with the option of raising rates above five percent annually with prior Departmental permission.<sup>5</sup>
- Eliminate or revise existing service quality standards for residential services set by the

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<sup>3</sup>(...continued)

20. Verizon is required to calculate price floors and ceilings on both state-wide and density zone bases so that the Department can determine whether to allow geographic deaveraging. Phase I Order, p. 101, n. 65. The Department will then compare the retail rates with the UNE costs and will “take appropriate steps to remedy the inefficiency,”(*id.*, p. 101) which appears to mean the Department will raise residential retail rates in the hopes of promoting competition. It is unclear whether this retail rate/UNE cost comparison will occur in Phase II or in some other docket. The Attorney General also notes that the Department did not notice DTE 01-20 as a retail ratemaking case.

<sup>4</sup> Verizon Phase II Plan, Tab B, Attachment II, page 7.

<sup>5</sup> Residential basic services are just those services for a single line, primary residence (Attachment A, Verizon Plan). Non-basic residential services, like three-way calling, voice mail, caller ID, blocking features, and call forwarding, are priced at market (unregulated) prices (Attachment B, Verizon Plan).

Department in DPU 94-50.<sup>6</sup>

- Increase the credit for its 163,000 subsidized LifeLine customers equal to the increase in residential dial-tone rate.
- Reduce Verizon's charges to payphone companies for public access lines (PAL) and public access smart lines (PASL) services.
- Reprice certain collocated Flexpath digital service lines under DTE tariff No. 10.
- Identify its business retail services that are comparable (contestable) as an unbundled network element (UNEs), per the Department's order.<sup>7</sup>

#### **D. The Department Seeks Comments on the Phase II Plan**

The Department requested comments on Verizon's Phase II Plan by June 25, 2002, and reply comments by July 11, 2002, but set no further procedural schedule, including no schedule for procedural conferences, discovery, prefiled testimony, rebuttal testimony, evidentiary hearings, or briefing.

### **III. ARGUMENT**

The Department's Phase I Opening, Scoping, and Final Orders have shaped the direction of its investigation into an appropriate alternative regulation plan for Verizon's intrastate retail services. However, Verizon's Phase II Plan does not comply with those directives and deviates substantially from its original alternative regulation plan, filed April 21, 2001 ("Phase I Plan").

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<sup>6</sup> "In its *Phase I Order*, the Department directed Verizon MA to include in this filing a proposal for service quality and associated penalties. Verizon MA does not believe that there is a need for the Department to impose retail service standards and penalties on any carrier given the extremely competitive markets in Massachusetts. The evidence in Phase I of this case demonstrates that Massachusetts is at the point where competitive forces, rather than government regulation, are sufficient to discipline Verizon MA ..." Verizon Phase I Compliance Filing, DTE 01-31, June 5, 2002, p. 8.

<sup>7</sup>Verizon Plan, Tab C. This is a summary listing and is not intended to be all-inclusive.

The Attorney General urges the Department to set a date for a procedural conference when the Department can set a schedule that allows sufficient time to investigate Verizon's Phase II Plan, alternate plans that the parties may propose, and set just and reasonable rates. G.L. c. 159, §§ 19, 20.

**A. The Department's Phase I Final Order Shifted the Investigation**

The Department said in its Phase I Scoping Order that Verizon, to comply with the terms of that order, must demonstrate that its regulatory framework will produce just and reasonable rates and will satisfy the Department's policy goals of "economic efficiency, fairness, universal service, simplicity, earnings stability, and continuity." *Id.*, pp. 15-16. The Department also said it would address in Phase II additional categories raised earlier by the parties, *i.e.*, universal service funding, price floors, access reform, full rate case, and earnings review. *Id.* at 18. However, the Department's tentative conclusions in the Phase I Final Order altered the course of its investigation dramatically.

**B. Tentative Conclusions Are More Than Just Guidance**

The Department said it has been "persuaded" to conclude that: (1) switched intrastate access rates should be reduced to the level of interstate levels; (2) special access rates should be reduced to UNE-based levels; (3) and Verizon is entitled to recover its revenue short-falls from these reductions by increasing the dial tone rates from its Massachusetts residential rate payers. None of these conclusions are based on the record in this docket, yet the Department presents them as conclusive presumptions made by administrative agency fiat.

The effect of its tentative conclusions, according to the Department, is to "guide" the



parties' future presentation of proof and evidence.<sup>8</sup> The Department's tentative conclusions, though, are not based on evidence produced in the record and appear to be more than mere "guidance." Rather, these conclusions resemble more an agency directive and are not subject to comment by the parties.<sup>9</sup>

### **C. These Conclusions Must Be Supported With Proof**

The Department must clearly and comprehensively explain its conclusions regarding the proper criteria governing the rate determination; otherwise, judicial review of the Department's substantive decision cannot be completed. *Washington Public Interest Organization v. Public Service Commission of the District of Columbia*, 393 A.2d 71, 75 (D.C. Cir. 1978). Furthermore, the Department's conclusions must be supported by substantial evidence or adequate subsidiary findings. G.L. c. 30A, § 11(8); *Massachusetts Institute of Technology v. Department of Public Utilities*, 425 Mass. 856, 684 N.E.2d 585, 593-597 (1997). The Department, in its Phase I Order, has failed to explain adequately its "tentative conclusion" that

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<sup>8</sup> Phase I Final Order, p. 94.

<sup>9</sup> This is in contrast to the approach used by the Federal Communications Commission ("FCC"). The FCC typically uses tentative conclusions to frame an issue and then invite comments from interested parties on those conclusions to test whether, in fact, those conclusions are correct. See, e.g., *In the Matter of Implementation of Sections 255 and 251(a)(2) of the Communications Act of 1934, as Enacted by the Telecommunications Act of 1996 Access to Telecommunications Service, Telecommunications Equipment and Customer Premises Equipment by Persons with Disabilities*, WT Docket No. 96-198, Report and Order and Further Notice of Inquiry (rel. September 29, 1999), para. 11; *In the Matter of Implementation of Section 273 of the Communications Act of 1934, as amended by the Telecommunications Act of 1996*, CC Docket No. 96-254, Notice of Proposed Rulemaking (rel. December 11, 1996), para. 7. However, the Department's language clearly and conclusively eliminated, without taking any evidence or comment, the consideration of any traditional rate-of-return regulation plan, despite its earlier pronouncements that such a regulation plan could be considered as part of Phase II. (Phase I Scoping Order, p. 18).

the UNE cost to wholesale competitors is the appropriate criteria for setting the price floor for residential retail rates. Absent an adequate explanation, the criteria cannot stand.<sup>10</sup>

The Department's "guidance" through the use of "tentative conclusions" does not relieve Verizon of its burden to prove that its proposed rate increases will result in "just and reasonable" rates as required under law. G.L. c. 159 § 17. A proposed utility rate cannot be deemed to be reasonable simply because the Department says it is; the Department must substantiate its finding with sufficient proof. Verizon must be given an opportunity to provide that proof, and the parties must be given an opportunity to examine that proof.

**D. The Department Must Set a Procedural Conference Date**

The Department must afford parties to this proceeding a full and fair opportunity to cross examine witnesses whose testimony supports Verizon's Phase II Plan. G.L. c. 30A, §11. Furthermore, it must give parties the chance to rebut Verizon's Phase II Plan with opposing testimony through supporting witnesses. The Department should allow parties to propose alternative regulatory plans, such as extending the DPU 94-50 Price Cap Plan which expired August 15, 2001. The Department, therefore, should schedule a procedural conference date to discuss the sequence of prefiled testimony, rebuttal testimony, discovery, evidentiary hearings and briefing.

Verizon's Phase II Plan varies significantly from its earlier Phase I version; consequently, the Department must take a fresh look at each element of the Company's recent

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<sup>10</sup> The issue of whether the Department may rely on tentative conclusions is covered in the Attorney General's pending Motion for Reconsideration, filed May 28, 2002.

filing. Examples of the issues that require further examination are as follows:<sup>11</sup>

**1. Calculation of Lost Access, PAL and PASL Revenues**

Verizon has estimated its calculations of lost revenues from access charges, public access lines (PAL) and public access smart lines at \$59 million. Thorough inquiry is necessary to determine whether Verizon's estimate is accurate.

**2. Over-Recovery of Lost Access Revenues**

Given that Verizon has about 2.75 million residential customers, a \$2 per month increase per customer (nearly a 20% rate increase to the dial tone rate) will allow Verizon to recover nearly \$66 million each year, which is about \$7 million more each year than its estimated lost access revenues (2,745,851 million x \$2 x 12 months = \$65,900,000). There appears to be a revenue gain, not a revenue-neutral adjustment as Verizon asserts.

**3. Five Percent Annual Rate Increases**

Another aspect of Verizon's Phase II Plan that must be investigated is whether the Company's proposal to increase basic residential rates up to five percent per year without prior Department approval is just and reasonable. See G.L. c. 159, §§ 19, 20. Verizon must establish that the automatic approval to raise rates five percent will not allow it to earn exorbitant returns. Moreover, Verizon must demonstrate that the UNE-priced floor (*e.g.*, the cost to provide wholesale service to competitors like AT&T) and the "stand-alone cost" ceiling present a range, described in the Department's Phase I Final Order, will create rates which are within the zone of reasonableness. Verizon must prove the necessity for the rate increases.

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<sup>11</sup> This is a partial listing and is not intended to be all-inclusive.

#### **4. Service Quality Plan – Need**

The Company must demonstrate the need to eliminate or modify its existing service quality plan adopted in DPU 94-50. In its Phase II Filing, Verizon asserts that service quality standards are not necessary because the market is “extremely competitive.” However, as we have seen in Phase I, Verizon controls 91 percent of the residential market, and the DTE, in its Phase I Final Order, stated that the residential portion of Verizon’s market must remain regulated. These facts belie Verizon’s assertions as to the level of competition in the residential market and reinforce the need for strong service quality plans with appropriate penalties.<sup>12</sup>

#### **5. Service Quality Plan – Changes from DPU 94-50**

Verizon asserts that a service quality plan, if required, should differ from the service quality plan established in DPU 94-50. In DPU 94-50, Verizon was required to report its performance on 33 metrics, aggregated according to the four service density zones. Verizon apparently intends to exclude the DPU 94-50 Price Cap Plan’s non-recoverable productivity offset.<sup>13</sup> Penalties, to be useful, must reflect more than just the cost of doing business, and to date Verizon has not produced any justification for reducing the financial disincentive for providing substandard service to customers. Furthermore, the Department should consider adding new service quality metrics, such as those that measure digital subscriber line (“DSL”) service quality.

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<sup>12</sup> “There is no such thing as a reasonable rate for service that is deficient.” C. Philips, *The Regulation of Public Utilities*, 553 (1993).

<sup>13</sup> “However, if the Department nevertheless decides to retain the Service Quality Plan adopted by the Department in D.P.U. 94-50, a different basis must be used to account for performance below threshold levels because the existing plan is based upon an indexed price cap formula which no longer exists.” *Id.*, p. 9.

## **6. Mandatory Touch-Tone Charges**

Verizon has over 2.75 million residential customers, of which 2 million customers already pay for Touch-Tone service. Verizon Phase II Plan, Attachment I, Tab B, Workpaper 1. Verizon's workpapers are unclear, but it appears that those 2 million customers' dial tone rates will rise \$1.90 (increasing basic monthly service from \$9.91 to \$11.81), whereas the remaining 750,000 Verizon customers' dial tone rates will increase \$2.37 per month (increasing basic monthly service from \$9.91 to \$12.28). This rate increase for Touch-Tone rate will apply to all residential customers, even those who have rotary phones and for those who do not want the service. Verizon must demonstrate that increasing these customers' rates for unneeded and unwanted service is "just and reasonable."

## **7. LifeLine Credits**

Verizon proposes to increase the credit for its 163,000 subsidized LifeLine customers equal to the increase in residential dial-tone rate. The Department must verify Verizon's calculations and determine whether any other subsidized rates, such as Link-Up programs, should also be increased so that those who cannot afford to pay full-price for basic residential services are not left without service.

## **8. Repricing DTE Tariff No. 10 - Flexpath**

Verizon proposes to reprice its collocated Flexpath digital service lines currently offered under DTE tariff No. 10. Verizon has not, however, adequately explained the need for repricing, or the effect on its revenues due to repricing.

## **9. Class Discrimination**

Since Verizon is no longer shielded by the Price Cap Plan's pricing rules, Verizon must

demonstrate that the Company has not discriminated against residential consumers as a class of customers. Verizon intends to impose a \$59 million dial tone/Touch-Tone rate increase on residential consumers to offset access rates that would have been paid by both business and residential consumers. This is especially troubling since Verizon eliminated the Touch-Tone charge for business customers entirely in 1999, resulting in a \$15.15 million revenue reduction.<sup>14</sup>

#### IV. CONCLUSION

The Attorney General requests that the Department set a date for a procedural conference, at which the parties will discuss dates for discovery, testimony, evidentiary hearings, and briefing. The parties and the Department need a full procedural schedule to determine whether Verizon's Phase II Plan will produce just and reasonable rates for regulated residential and business services.

Respectfully submitted  
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Dated: June 25, 2002

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<sup>14</sup> *Bell Atlantic's Fifth Annual Price Cap Compliance Filing*, November 17, 1999, Section B, Tab 1, page 5 of 8.

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DEPARTMENT OF TELECOMMUNICATIONS AND ENERGY**

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**CERTIFICATE OF SERVICE**

I hereby certify that I have this day served the foregoing document upon each person designated on the official service list compiled by the Secretary in this proceeding by e-mail and either hand-delivery or U.S. mail.

Dated at Boston this 25th day of June 2002.

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